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No. 392

In the Supreme Court of the United States

OCTOBER TERM, 1960

UNITED STATES OF AMERICA, PETITIONER

v.

GEORGE E. SHIMER

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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The Solicitor General, on behalf of the United States, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit entered in the above case on April 8, 1960.

OPINIONS BELOW

The opinion of the United States District Court for the Eastern District of Pennsylvania (R. 9a–13a)[1] and the same court's order of June 24, 1959, confirming its previous opinion (R. 17a), are not reported. The opinion of the Court of Appeals (App. B, *infra*, pp. 22–32) is reported at 276 F. 2d 792.

[1] All record references are to the pages of Appendix B to the brief for the United States in the Court of Appeals—which constituted the record before the court below.

JURISDICTION

The judgment of the Court of Appeals was entered on April 8, 1960 (App. B, *infra*, pp. 32–33). By order of Mr. Justice Brennan, dated June 30, 1960, the time within which to file a petition for a writ of certiorari was extended to and including August 22, 1960. By order of Mr. Justice Black, dated August 18, 1960, a further extension was granted until and including September 6, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the liability of the Veterans Administration to pay the holder of an indebtedness guaranteed by the Administrator of Veterans Affairs under the G.I. home loan program, and the obligation of the veteran borrower to reimburse the Veterans Administration for the amount paid to the holder in satisfaction of the guaranty, are subject to state deficiency judgment (and comparable) legislation.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in Appendix A, *infra*, pp. 17–21.

STATEMENT

This suit was filed by the United States to recover the amount paid out by it under its guaranty, as a result of default by respondent in payment of his G.I. home loan. The basic facts are not in dispute and in large part were stipulated by the parties in the District Court (R. 15a–16a).

On January 12, 1948, respondent obtained a loan of $13,000 from the Excelsior Saving Fund and Loan

Association (the "bank" or "mortgagee") to purchase a home in Whitemarsh Township, Montgomery County, Pennsylvania. The loan was to be repaid with interest at 4 percent per annum in monthly installments of $78.78 over a twenty year term. It was evidenced by a bond and secured by a mortgage on the property purchased, and these were executed by respondent and his wife. On February 6, 1948, respondent applied to the Administrator of Veterans Affairs for a guaranty of his loan under the provisions of the Servicemen's Readjustment Act of 1944, as amended, and for this purpose he signed Veterans Administration Form 4–1820, "Home Loan Report." This report on its face states that "[r]egulations issued under the act, and in effect on the date of any loan which is submitted and accepted or approved for a guaranty or for insurance thereunder shall govern the rights, duties, and liabilities of the parties to such loan and any provisions of the loan instruments inconsistent with such regulations are hereby amended and supplemented to conform thereto. (Section 4334 of the Regulations)" (R. 16a).

The Veterans Administrator approved the Home Loan Report and the application for guaranty, and on February 11, 1948, issued VA Form 4–1899, "Loan Guaranty Certificate", guaranteeing "[s]ubject to the Servicemen's Readjustment Act of 1944, as amended, Public Law 268, 79th Congress, and the regulations issued thereunder to the date of this certificate, 37.38 percent of the indebtedness outstanding from time to time under the loan identified above." Ap-

plied to the $13,000 loan, this percentage equalled $4000, taking into consideration the statutory maximum.

On May 12, 1948, respondent defaulted in payment of the loan, and after continued default the bank filed with the Veterans Administration, on April 12, 1949, a Notice of Intention to Foreclose. By May 12, 1949, the bank entered judgment against respondent and his wife in the Court of Common Pleas of Montgomery County, Pennsylvania, to foreclose the mortgage on the property purchased with the loan. At a sheriff's sale on June 29, 1949, the property was purchased by the bank upon a bid of $250.00. On July 8, 1949, the bank filed a claim with the Veterans Administration for payment of the loan guaranty of $4000.00, and the Administrator paid this amount to the bank on October 7, 1949. The bank had meanwhile, on September 8, 1949, sold the property to third parties for $10,500.00. The bank did not file a petition for assessment of the "fair value" of the property under the provisions of the Deficiency Judgment Act of the Commonwealth of Pennsylvania, Act of 1941, July 16, P.L. 400, Section 1, 12 Pa. Stats., Section 2621.1, *et seq., infra,* pp. 20–21.

Thereafter, the United States filed a complaint in the District Court against respondent, in two counts. The first asserted the government's claim as subrogee of the rights of the mortgagee-bank, and the second asserted its claim for indemnity (R. 3a–5a). Respondent's answer asserted that, in view of the operation of the state law concerning deficiency judgments after the sale of real property subject to mortgage foreclosures, the Veterans Administration

had paid the bank at a time when the veteran was under no obligation to the bank, the payment was therefore improper and was not reimbursable (R. 6a–7a). The District Court rejected both bases of recovery asserted by the United States, holding (R. 9a–13a):

> * * * that the Pennsylvania Deficiency Judgment Act is applicable in the instant case, and that alleging that the mortgagee bank failed to comply with the provisions thereof is a valid defense to this suit.

The court rejected the subrogation claim on the ground that respondent's state law defense against the bank, based upon the bank's failure to secure a judicial appraisal of the fair value of the mortgaged property, could be asserted also against the United States as subrogee of the bank.[2] The claim for indemnity was denied on the ground that, under the state deficiency judgment law, the Veterans Administration paid the guaranty when the respondent was not obligated to the bank, that therefore the VA payment to the bank was not a payment made "on account of the liabilities" of a veteran, and accordingly did not constitute a debt of the veteran owing to the United States under Veterans Administration Regulation 36.4323(e), which provides:

> Any amounts paid by the Administrator on account of the liabilities of any veteran guaranteed or insured under the provisions of the act shall constitute a debt owing to the United

[2] The United States did not appeal from this ruling against its claim as subrogee of the bank's rights, and it does not seek to raise the subrogation issue in this Court.

States by such veteran. [38 C.F.R. 1949 ed., 36.4323(e)]

The Court of Appeals affirmed. It held that the obligation of the Administrator under the Veterans Administration's guaranty is to pay no more than the deficiency after foreclosure and sale and that this amount is to be determined exclusively by state law (App. B, *infra*, p. 26):

> An examination of the Act fails to disclose any attempt on the part of Congress to supplant state law for determining the amount of the deficiency on the loan between the mortgagor and the mortgagee, which deficiency, up to the statutory limit, is the amount and the only amount which may be paid by the V.A. under the guaranty. The regulations promulgated under the Act make it equally clear, as we later demonstrate, that state law was intended to be followed in determining the amount of the indebtedness to which the guaranty related.

The court further ruled that the amount payable by the respondent veteran to the Government on the Government's indemnity claim "is limited to the amount which the V.A. under the statute is *required* to pay on its guaranty and not the amount which it actually pays" (App. B, *infra*, p. 26). Since, under this interpretation, the Veterans Administration, in the light of Pennsylvania law, was not required to pay anything at all to the lender bank, the Court of Appeals affirmed the District Court's dismissal of the Government's indemnity claim against the respondent.

REASONS FOR GRANTING THE WRIT

The decision below, in drastically but unjustifiably restricting the extent of the Federal Government's obligation to lending institutions participating in the G.I. home loan program, immediately jeopardizes that significant program to such an extent as to make review essential at this time. The need for review is underscored because the opinion of the Court of Appeals is (1) contrary to the requirements of the controlling federal statute and its legislative history, as well as the consistent and fully expressed administrative construction from the time of the passage of the relevant provisions of the Act in 1944 and 1945; and (2) appears inconsistent with a ruling of the Court of Appeals for the Ninth Circuit as well as other lower court decisions.

1. Because of its holding that the Veterans Administration is not liable to the lending institution until state deficiency judgment proceedings have been instituted and completed, the Third Circuit's decision threatens to bring to a halt a nation-wide program which fosters the purchase by veterans of their own homes, a broad and beneficial program designed by Congress to facilitate veterans' readjustment to civilian life.[3] The general economic and social impact of this G.I. home loan program, over the past decade and a half, has been of great magnitude, at relatively

[3] Congress recently extended the program for two years until July 25, 1962, for World War II veterans (Public Law 86-665, signed July 14, 1960). About 14 million veterans are still eligible for loan benefits under the program; of these, over 10 million are World War II veterans. Korean veterans are eligible until 1965.

small cost to the Government.[4] The crux of the program has been that the Government's guaranty was designed to take the place, so far as the lender is concerned, of the home purchaser's cash down-payment which would otherwise have to be made—the cash equity of the borrower in mortgaged property without which lenders normally do not advance funds and on which the lender can always count in the event of default.

In a private loan with a substantial down payment, the lender is assured on default of getting at least the full down-payment, plus whatever he can actually realize out of the foreclosed property; he may also be able to obtain a deficiency judgment against the borrower (in many states) if he can establish a "fair market value" for the property less than the indebtedness due. Under the G.I. home loan program, as it has been administered up to this time, the lender is assured on default of getting at least the full amount of the guaranty (which stands for him in the place of the down-payment),[5] plus what he can realize from the property; he may also be able in appropriate cases to obtain a deficiency judgment. However, un-

[4] As of July 31, 1960, almost 6 million veterans have acquired homes under this program. Of these, the veteran has defaulted in only 1.1%. In this case, respondent made no down-payment and none was required of him (*supra*, p. 3). The guaranty was the equivalent in this case to a down-payment of over 30%.

[5] General Omar Bradley, then Administrator of Veterans Affairs, stressed, in his testimony before the Senate Finance Committee, that the guaranty provision "was intended to provide what ordinarily is required as a down payment in connection with purchasing a home, farm, business, et cetera. In other words, the guaranty took the place of the purchaser's equity." It must be remembered, too, that the governmental security

der the rulings of the Court of Appeals in this case, the lender (in many jurisdictions) is assured of only the amount he can realize from the mortgaged property; he ordinarily has no cash down-payment on which to rely and he can reach the Government's guaranty only to the extent that he establishes in deficiency judgment proceedings a "fair market value" for the property less than the debt.

The decision below thus strikes at the heart of the VA program by destroying the substitute protection—the protection which takes the place of the cash down-payment—conferred on lenders by the Government guaranty. Since the decision means that any losses suffered on default in these circumstances would not have to be borne by the Government, but would be shouldered exclusively by the lender, lenders can be expected to withdraw completely from the program. If lenders must stand the risks of the G.I. home loan program alone—without the protection afforded by a large cash down-payment, without the substitute protection given by the guaranty mechanism as understood up to this time, and at interest rates measurably below those available in private financing—lenders will not lend under a G.I. guaranty and there will be no G.I. home loan program. This is the well-founded fear of the Veterans Administration, based upon its experience and inquiries from lending institutions since the announcement of the decision below. Just as maintenance of negotiability is the guiding star of negotiable instruments law—for the benefit of society

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provided was a guaranty and not an indemnity. In other words, the Government, to the extent as to the amount guaranteed, absorbs the loss instead of sharing it with the creditor." (Senate Hearings on H.R. 3749, 79th Cong., 1st Sess., 1945, p. 31). See, also, *infra*, pp. 11–12.

generally—so the ability to obtain lenders is essential to this loan program—for the benefit of all veterans.*

2. The obligation of the Veterans Administration under its guaranty to the lender is spelled out simply and clearly by Section 506 of the Servicemen's Readjustment Act, App. A, *infra*, p. 18. Under Section 506, the Federal Government's obligation is one of absolute guaranty under which liability is incurred immediately upon default:

> In the event of default in the payment of any loan guaranteed under this subchapter, the holder of the obligation shall notify the Administrator who shall thereupon pay to such holder the guaranty * * *.

And, for some 14 years, the Administrator, in interpreting Section 506, has ruled that the liability under the guaranty is absolute (2 Administrator's Decisions, Veterans' Administration, Nos. 589 and 625). Thus, in the present case, the Government, recognizing its guaranty liability as absolute under the Act and following its regular practice, paid the lending institution, upon respondent's default, the full

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*The Veterans Administration advises that there are approximately 255,700 G.I. loans now outstanding in Pennsylvania alone, involving a principal balance of approximately $1,750,000,000. Also, approximately 5,000 VA claims arising out of loans made in Pennsylvania have been previously adjudicated under the VA's interpretation of the program, and the VA can reasonably anticipate requests from many of those veterans to review these claims in the light of the decision below.

Moreover, it should be pointed out that, in view of the large number of states having deficiency judgment legislation (including Georgia, Maryland, New York, Idaho, Ohio, South Carolina, Michigan, North Dakota, Mississippi, Oklahoma,

guaranty of $4,000.[7] The decision below, in sharp contrast, holds that under Pennsylvania law this $4,000 payment was improper and that the Government was not required to pay anything at all to the lender.

For this conclusion, the Third Circuit mistakenly relies on an earlier version of Section 506 which never became law.[8] It is this error that led the court below to fail to recognize the absolute nature of the guaranty liability at the time of default—and to rule, instead, that liability under the guaranty arises only after a determination of deficiency on foreclosure. When

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Louisiana, Wisconsin, and Vermont), the future impact of the Third Circuit's conclusions will not, in all probability, be confined to the Third Circuit—itself an important region of the country. Also, very large numbers of claims against veterans have been processed and collected, in circumstances comparable to those presented here, throughout the country during the past 16 years. See fn. 15, *infra*, p. 15.

[7] Pursuant to its interpretation of the basic statute, the Veterans Administration's regulations provide that the lender's claim shall consist of the guaranty, less certain credits. In the case of a foreclosure sale, as here, in which no upset price has been established by the VA, the lender, in settling with the Administrator, credits against the guaranty payable the net proceeds of the sale. Veterans Administration Regulations 36.4321(a), 36.4321(b) and 36.4320(a)(4), 38 C.F.R. (1949 ed.), 36.4321 (a) and (b), 36.4320(a)(4). See also the regulation's definition of the guaranty, *infra*, pp. 18–19.

The provisions of these regulations are incorporated into the contract with the veteran and the bank. Veterans Regulation 36.4334, 38 C.F.R. (1949 ed.) 36.4334.

[8] In this connection, the court's opinion quotes (App. B, *infra*, p. 25) some sentences from the Statement of the House Managers on the Report of the Committee of Conference, dated December 17, 1945, *describing the House bill*. These sentences describe the Government's liability to the lender under the House bill as being "not in excess of the deficiency" determined after foreclosure and sale.

some of the loan guaranty provisions of Title III of the Servicemen's Readjustment Act of 1944 were found to be unacceptable to some mortgage lenders, Title III of the Act was completely rewritten in 1945. In the Resolution which originated in, and was passed by the House in 1945,[9] provision was made for the guaranty to apply, after foreclosure, only to the deficiency—in effect, an indemnity rather than an absolute guaranty. When hearings were held in the Senate, the testimony of General Omar Bradley, then Administrator of Veterans Affairs,[10] and Mr. Morton Bodfish, Executive Vice President of the United States Savings and Loan League, Chicago, Illinois,[11] showed that the House version would not be acceptable to lenders in place of the cash down-payment usually required in mortgage lending, since a substantial part of the loss from the deficiency would always fall on the lender. As a result of this testimony, the Senate rewrote and passed Section 506 to read as it now reads—*i.e.*, to retain the absolute guaranty feature of the program.[12] In the Conference Committee the House receded from its provision and accepted the Senate version of Section

[9] H. Res. 3749, 79th Cong.

[10] Senate Hearings on H.R. 3749, 79th Cong., 1st Sess. (1945), before a Subcommittee of the Senate Committee on Finance, pp. 31–33; see also fn. 5, *supra*, p. 8.

[11] *Ibid.*, pp. 169–170. See also the similar testimony of Chester R. Davis, Chairman, American Bankers Association Committee on Service for Veterans; the Association's membership of 15,000 banks represents about 98% of the total banking resources of the country. *Ibid.*, pp. 349–350.

[12] S. Rept. 698 (Senate Committee on Finance), to accompany H.R. 3749, 79th Cong., 1st Sess., p. 5.

506.[13] The House then passed the measure as amended by the Senate and it was signed by the President. Nevertheless, the court below has primarily based its holding on the original House version of Section 506, despite the fact that that version was discarded and a different one enacted in order to avoid the results which would have followed from passage of the original proposal.[13a]

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[13] Although it recognizes that the final bill accepts much of the Senate's loan provisions, the Statement of the House Managers on the Conference Report (H. Rept. No. 1449, 79th Cong., 1st Sess., p. 17) does state that "Section 506, relating to procedure on default, is retained substantially as in the House bill." This is an over-statement, as comparison of the two provisions will reveal. In particular, the portions of the House bill providing for computation of the Government's liability after ascertainment of the deficiency were *not* retained in the final measure but were significantly changed (as Section 506 shows).

That the Senate completely rejected the House proposal to substitute an indemnity for the absolute guaranty is clear from the Senate report on the Senate version (S. Rept. No. 698, p. 4):

"It is appropriate to point out here *an important difference between the House bill and the bill reported by your committee*, as relates to loans. *Under the House bill*, by amendments to section 500(a) and elsewhere in the Readjustment Act, the lending agency and the veteran were in effect permitted to make their own bargain, and the loan is automatically guaranteed 50 percent by the Administrator of Veterans' Affairs. This would afford no protection either to the veterans or to the Government. *Your committee did not accept this plan and has retained the basic principles of the existing law with such changes as may be necessary* in section 500(a) and in other provisions which will be noted, to liberalize and clarify the law. *At the same time, there is preserved the guaranty principle of the existing act instead of the House provision, which is in effect a contract of indemnity, with the lender and the Government sharing the loss pro rata.*" [Emphasis added.]

[13a] That Congress knew the difference between a guaranty and an indemnity is clearly shown by Sec. 508, 38 U.S.C. (1952 ed.) 694i.

3. In our view, the decision of the court below is inconsistent with *McKnight* v. *United States*, 259 F. 2d 540 (C.A. 9), as well as with *United States* v. *Gallardo*, 154 F. Supp. 373 (N.D. Cal.); *United States* v. *Jones*, 155 F. Supp. 52 (M.D. Ga.); *United States* v. *Henderson*, 121 F. Supp. 343 (S.D. Iowa); and *Stalcup* v. *Easterly*, 351 P. 2d 735 (Okla. Sup. Ct.).[14] Indeed, the law had been considered to be well settled until the adverse decision in the present case. The same basic question was involved in each of these cases—the right of the Veterans Administration to be reimbursed for the amount paid on the guaranty when no deficiency judgment was obtained under state law. In *McKnight*, there was no liability enforceable under state law for a deficiency at the time the claim on the guaranty was paid by the Government. The veteran contended there (as the court below held here) that there was no liability on the veteran to reimburse the Government because there was no liability of the veteran to pay the lender at the time the Veterans Administration paid the guaranty. The Ninth Circuit rejected this contention, and in holding that it need not determine whether the California Deficiency Judgment Act applied, stated (259 F. 2d at 543, 544):

> We rely on the general proposition that the subject matter of this litigation arises under the federal law and cannot be impaired by a state statute. * * *

Recognizing that the veteran had been sued on his independent contract of indemnity, and not for any

[14] There have been a great many comparable decisions in the federal district courts in which no opinions have been written.

deficiency judgment, the court on this basis affirmed a judgment for the United States.

This result is also suggested by *Wissner* v. *Wissner*, 338 U.S. 655. This Court there held that the proceeds of a National Service Life Insurance policy were to be distributed according to the terms of the policy itself without regard to the conflicting provisions of California community property laws. To interpret the policy in terms of state law, said the Court, would frustrate "the deliberate purpose of Congress," 338 U.S. at 659. Here, too, the Government's right of indemnity from the veteran, as a valid part of the statutory and regulatory scheme governing the rights and duties of the parties under a contract to guarantee a federal home loan, cannot be diminished or destroyed by provisions of state law. In the event of a conflict between the regulation providing for indemnity and provisions of Pennsylvania law restricting that right, the Supremacy Clause of the Constitution makes it clear that the federal legislation and regulations must govern.[15]

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[15] It has been the regular practice of the Veterans Administration, over the past 16 years, to hold the veteran liable for amounts properly paid to the lender under the guaranty. This is provided explicitly by regulation (App. A, *infra*, p. 20), and the VA has processed a very large number of claims against veterans in circumstances identical or similar to those involved here. Many of these claims have been collected from other monies due the veteran, and many suits have also been brought. See also fn. 6, *supra*, pp 9–10, and p. 14, *supra*.

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CONCLUSION

It is respectfully submitted that this petition for a writ of certiorari should be granted.

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APPENDIXES

APPENDIX A

STATUTES AND REGULATIONS INVOLVED

1. The Servicemen's Readjustment Act of 1944, as amended, 38 U.S.C. 694, *et seq.* (as it appears in the 1952 edition of the United States Code),[1] provides in pertinent part as follows:

Section 500(b), 38 U.S.C. 694(b):

> (b) *Terms and conditions; interest.*
>
> Loans guaranteed under this subchapter shall be payable under such terms and conditions as may be agreed upon by the parties thereto, subject to the conditions and limitations of this subchapter and the regulations issued pursuant to section 694d of this title: *Provided,* That the liability under the guaranty within the limitations of this subchapter shall decrease or increase pro rata with any decrease or increase of the amount of the unpaid portion of the obligation: *Provided further,* That loans guaranteed under this subchapter shall bear interest at a rate not exceeding 4 per centum per annum and shall be payable in full in not more than thirty years, or in the case of loans on farm realty in not more than forty years: *And provided further,* That (1) the maturity of a non-real-estate loan shall not exceed ten years; (2) any loan for a term in excess of five years shall be amortized in accordance with established procedure; (3) except as provided in section 694e of this title any real-estate loan, other than for repairs,

[1] Recodified January 1, 1959, as 38 U.S.C., Chapter 37.

alterations or improvements, shall be secured by a first lien on the realty, and a non-real-estate loan, except as to working or other capital, merchandise, good-will and other intangible assets, shall be secured by personalty to the extent legal and practicable: *And provided further,* That the Administrator, with the approval of the Secretary of the Treasury, may prescribe by regulation a higher maximum rate of interest than otherwise prescribed in this section for loans guaranteed under this subchapter, but not exceeding 4½ per centum per annum, if he finds that the loan market demands it.

* * * * *

Section 504(a), 38 U.S.C. 694d(a):

* * * * *

(a) The Administrator is authorized to promulgate such rules and regulations not inconsistent with this subchapter, as are necessary and appropriate for carrying out the provisions of this subchapter * * *

* * * * *

Section 506, 38 U.S.C. 694g:

* * * * *

In the event of default in the payment of any loan guaranteed under this subchapter, the holder of the obligation shall notify the Administrator who shall thereupon pay to such holder the guarantee not in excess of the pro rata portion of the amount originally guaranteed, and shall be subrogated to the rights of the holder of the obligation to the extent of the amount paid on the guaranty:

* * * * *

2. Veterans Administration Regulation 36.4301(q), 38 C.F.R. (1949 ed.), 36.4301(q), provides as follows:

(q) "Guaranty" means the obligation of the United States, assumed by virtue of Title III

of the act, to repay a specified percentage of a loan upon the default of the primary debtor.

Veterans Administration Regulation 36.4321 (a) and (b), 38 C.F.R. (1949 ed.) 36.4321 (a) and (b), provide as follows:

> *Computation of guaranty claims; subsequent accountings.*—(a) Subject to the limitation that the total amounts payable shall in no event exceed the amount originally guaranteed, the amount payable on a claim for the guaranty shall be the percentage of the loan originally guaranteed applied to the indebtedness computed as of the date of claim but not later than (1) the date of judgment or of decree of foreclosure or (2) in non-judicial foreclosures the date of publication of the first notice of sale, or (3) in cases in which the security is repossessed without a judgment, decree or foreclosure the date the holder repossesses the security, or (4) if no security is available, or no possession takes place, the date of claim but not more than 6 months after the first uncured default. Deposits or other credits or setoffs legally applicable to the indebtedness on the date of computation shall be applied in reduction of the indebtedness on which the claim is based. Any escrowed or earmarked funds not subject to superior claims of third persons must likewise be so applied.
>
> (b) Credits accruing from the proceeds of a sale or other disposition of the security subsequent to the date of computation, and prior to the submission of the claim, shall be reported to the Administrator incident to such submission, and the amount payable on the claim shall in no event exceed the remaining balance of the indebtedness.

Veterans Administration Regulation 36.4323, 38 C.F.R. (1949 ed.) 36.4323, provides in pertinent part as follows:

Subrogation and indemnity.—(a) The Administrator shall be subrogated to the contract and the lien or other rights of the holder to the extent of any sum paid on a guarantee or on account of an insured loss * * *. No partial or complete release by a creditor shall impair the rights of the Administrator with respect to the debtor's obligation.

* * * * *

(e) Any amounts paid by the Administrator on account of the liabilities of any veteran guaranteed or insured under the provisions of the act shall constitute a debt owing to the United States by such veteran.

3. The pertinent provisions of the Pennsylvania Deficiency Judgment Act (Commonwealth of Pennsylvania, Act of July 16, 1941, 12 Pa. Stats. Section 2621.1, *et seq.*), are as follows:

2621.1—Whenever any real property has heretofore been or is hereafter sold, directly or indirectly, to the plaintiff in execution proceedings and the price for which such property has been sold was or is not sufficient to satisfy the amount of the judgment, interest and costs and the plaintiff seeks to collect the balance due on said judgment, interest and costs, the plaintiff or plaintiffs shall petition the court having jurisdiction to fix the fair market value of the real property sold as aforesaid. * * *

2621.6—* * * After the hearing and the determination by the court of the fair market value of the property sold the debtor, obligor, guarantor and any other person liable directly or indirectly to the plaintiff or plaintiffs for the payment of the debt shall be released and discharged of such liability to the plaintiff to the extent of the fair market value of said property as previously agreed to by the plaintiff or plaintiffs or determined by the court * * * and thereupon petitioner may proceed by appropri-

ate proceedings to collect the balance of the debt.

2621.7—The plaintiff or plaintiffs shall file all petitions in accordance with section one and section two of this act not later than six months after the sale of any real property: * * * In the event no petition is filed within such period, the debtor, obligor, guarantor and any other person liable directly or indirectly to the plaintiff or plaintiffs for the payment of the debt shall be released and discharged of such liability to the plaintiff or plaintiffs.

APPENDIX B

In the United States Court of Appeals for the Third Circuit

No. 13067

UNITED STATES OF AMERICA, APPELLANT

v.

GEORGE E. SHIMER

On Appeal From the United States District Court for the Eastern District of Pennsylvania

Argued February 18, 1960

Before BIGGS, *Chief Judge,* and STALEY and HASTIE, *Circuit Judges*

OPINION OF THE COURT
(Filed April 8, 1960)

By STALEY, *Circuit Judge:*

Is the amount the Veterans Administration can recover on its contract of indemnity with a Pennsylvania veteran limited to the amount which the veteran owes his mortgagee at foreclosure, and must that amount be computed in accordance with Pennsylvania law, including the Pennsylvania Deficiency Judgment Act?[1]

The facta as taken from the stipulation entered into by the parties are as follows: Appellee, George E. Shimer, obtained a loan of $13,000 from the Excelsior, Saving Fund and Loan Association (Associa-

[1] 12 Purdon's Pa. Stat. Ann. § 2621.1 et seq.

tion) on January 12, 1948, to purchase residential realty in Whitemarsh Township, Montgomery County, Pennsylvania. The loan was evidenced by a bond and secured by a mortgage on the property issued to the Association on the same date, January 12, 1948, both having been executed by George E. and Mildred F. Shimer, his wife. The loan was to be repaid with interest at 4 per cent per annum in monthly installments of $78.78 over a term of twenty years. Within a month appellee, an eligible veteran, applied to the Veterans Administration (VA) for guaranty of said loan pursuant to the provisions of Title III of the Servicemen's Readjustment Act of 1944, as amended, 59 Stat. 626, 38 U.S.C. § 694, et seq. (now 38 U.S.C. § 1801 et seq.), on VA Form 4–1820, "Home Loan Report." Shortly thereafter, on February 11, 1948, the VA aproved the application and issued VA Form 4–1899, "Loan Guaranty Certificate," guaranteeing "subject to the Servicemen's Readjustment Act of 1944, as amended, Public Law 268, 79th Congress, and the regulations issued thereunder to the date of this certificate, 37.38 per cent of the indebtedness outstanding from time to time under the loan identified above." Pursuant to the provisions as applied to this $13,000 loan, the guaranty amounted to $4,000. Appellee defaulted on May 12, 1948, and continued in default. On April 12, 1949, the Association filed a Notice of Intention to Foreclose with the VA, and on May 12, 1949, entered judgment in the Court of Common Pleas of Montgomery County, Pennsylvania, at No. 351, April Term, 1949, to foreclose the mortgage on the property purchased with the loan. Sheriff's sale followed on June 29, 1949, where the property was purchased for $250 by the Association. The Association thereupon filed a claim with the VA for payment of the $4,000 loan guaranty on July 8,

1949, and the VA paid this amount on October 7, 1949. While this claim was pending before the VA, the Association sold the property to third parties for $10,500. At no time did the Association comply with the provisions of the Pennsylvania Deficiency Judgment Act.

This action was initiated in the District Court for the Eastern District of Pennsylvania by the United States to recover the sums paid by the VA to the Association. The government asserted it was entitled to recover under either of two counts. The first count was based on its rights as a subrogee of the Association,[2] and the second count was based on a right of indemnity. An answer was filed by the appellee alleging that no obligation existed under either theory inasmuch as the mortgagee after it purchased the property at judicial sale had failed to file a petition to fix the fair market value of the property pursuant to the Pennsylvania Deficiency Judgment Act. The government thereafter filed a motion for judgment on the pleadings which was denied by the district judge in an opinion issued December 17, 1958. The parties entered into a stipulation of facts, and the district court thereafter granted appellee's motion for summary judgment on June 24, 1959, under Rule 56(b).

On appeal the government contends that it is entitled to indemnity for the loss which it suffered as guarantor of the loan on the basis of valid regulation binding upon the appellee that is not impaired or limited in any way by the provisions of Pennsylvania law concerning deficiency judgments. The government asserts that "the court below has grafted onto the rights and liabilities running between the United

[2] The government has evidently abandoned its claim as subrogee, for in its appeal it has not raised that issue.

States and defendant [appellee] in their independent contract of indemnity, state law considerations *which have point only respecting the relationship between defendant and the bank in the first instance,* or secondarily between the defendant and the bank's subrogee. We think it clear that state law control of this latter relationship can affect only those rights which the subrogee takes through the bank, and cannot affect other rights independently transacted." (Emphasis supplied.)

We agree with the government that an independent indemnity relationship was created by the veteran's application for guaranty of his loan. We further agree that the terms of that guaranty are governed by the Servicemen's Readjustment Act of 1944, as amended, (Veterans Act) and the regulations promulgated pursuant thereto. Although Section 506 of the Act, 38 U.S.C. (1952 ed.) § 694g, entitled "Procedure on default," authorizes payment of the guaranty by the VA in the case of each and every default, it does not purport to spell out the amount which is to be paid; it merely refers to the guaranty. The House Report of the Committee of Conference, dated December 17, 1945, U.S. Code Cong. Serv., 79th Cong., 1st Sess. (1945) 938–939, in considering the procedure on default, stated that "In the event the veteran defaulted in payment of his loan and after suit on foreclosure and sale *the deficiency was determined,* then upon notification from the lender, the Administrator would pay to the lender its guaranty not in excess of $2,000 and not in excess of *the deficiency,* and be subrogated to the rights of the lender to the extent of the amount paid on the guaranty." [3] (Emphasis supplied.)

[3] The Senate Bill was substituted for the House Bill; however, on page 940 of the same report, it is stated: "Section

An examination of the Act fails to disclose any attempt on the part of Congress to supplant state law for determining the amount of the deficiency on the loan between the mortgagor and the mortgagee, which deficiency, up to the statutory limit, is the amount and the only amount which may be paid by the VA under the guaranty. The regulations promulgated under the Act make it equally clear, as we later demonstrate, that state law was intended to be followed in determining the amount of the indebtedness to which the guaranty related.

Although the government concedes, as we have heretofore noted, that state law applies to the basic indebtedness between the mortgagor and the mortgagee, it maintains that state law does not apply to the indemnity agreement between the veteran and the government. It seemingly asserts that it can recover under the indemnity agreement whatever amount it paid to the mortgagee. The amount payable under the indemnity agreement, however, is limited to the amount which the VA under the statute is *required* to pay on its guaranty and not the amount which it actually pays. As we have indicated, the amount which it is legally required to pay is the deficiency on foreclosure. That deficiency represents the then indebtedness between the mortgagor and the mortgagee.

The government principally relies on a regulation, since modified, which stated that "Any amounts paid to the creditor by the Administrator pursuant to the guaranty shall constitute a debt due to the United States by the veteran on whose application the guaranty was made * * *." 38 Code Fed. Regs. (1944 Supp.) § 36.4043. This is hardly persuasive,

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506, relating to procedure on default, is retained substantially as in the House Bill."

for that regulation was modified to read "Any amounts paid by the Administrator *on account of the liabilities* of any veteran guaranteed or insured under the provisions of the act shall constitute a debt owing to the United States by such veteran." 38 Code Fed. Regs. (1949 ed.) § 36.4323(e). In any case, even under the earlier regulation the amounts to be paid were regulated by the guaranty, and this was intended only to reimburse the mortgagee in an amount not to exceed the loss he might suffer through default computed as of the date of foreclosure. See 38 Code Fed. (1956 rev.) § 36.4320(a)(3)(iii) and (4)(d). Since the section in the regulations upon which the government relies, i.e., 38 Code Fed. Regs. (1949 ed.) § 36.4323(e), refers to the "liabilities of any veteran" (to the mortgagee) and the entire Veterans Act refers to an underlying obligation created by state law, we are convinced that federal law requires a referral to the state law in this instance.

In addition, Section 36.4321, entitled "Computation of guaranty claims; subsequent accounts," specifically indicates such a procedure in subsection (a), for it provides:

> Subject to the limitation that the total amounts payable shall in no event exceed the amount originally guaranteed, the amount payable on a claim for the guaranty shall be the percentage of the loan originally guaranteed applied to the indebtedness computed as of the date of claim but not later than (1) the date of judgment or of decree of foreclosure * * *. *Deposits or other credits or set-offs legally applicable to the indebtedness* on the date of computation *shall be applied in reduction of the indebtedness* on which the claim is based. Any escrowed or earmarked funds not subject to

superior claims of third persons must likewise be so applied. [Emphasis supplied.][4]

Certainly, one must refer to state law to discover what credits or set-offs are legally applicable to the indebtedness between the mortgagor and the mortgagee. In the instant case where Pennsylvania law is applicable, including the Pennsylvania Deficiency Judgment Act, on the critical date, the date of judgment or of decree of foreclosure, the appellee had a set-off or credit. The Pennsylvania law provides that where the mortgagee purchases the property at foreclosure, the fair market value of the property must be applied against the debt.[5] It also provides

[4] If this or any other regulation issued by the Administrator be interpreted to deny to the veteran-mortgagor the defense of payment to the mortgagee either partial or complete such regulation would be invalid as being contrary to the Act. See 38 U.S.C. (1952 ed.) § 694(b), presently codified in 38 U.S.C. (1958 ed.) § 1803(b), (c) and (d).

[5] In *Sophia Wilkes Bldg. & Loan Ass'n* v. *Rudloff*, 348 Pa. 477, 35 A.2d 278 (1944), it was stated:

"'* * * The act, recognizing plaintiff's right to recover the full amount of the judgment, merely provides for an inquiry in regard to a transaction which occurred subsequent to the judgment, to wit, [what occurred at] the sheriff's sale, in order to ascertain what amount of payment plaintiff has received, such an inquiry being analogous to the trial of an issue of payment raised as a defence * * *.'" 35 A.2d at page 280.

"* * * [T]he defendant is entitled to have the judgment against him satisfied of record, for it has been discharged as completely and effectually as if it had been actually paid off in cash." 35 A.2d at page 280.

"We merely recognize and give effect to the repayment of the judgment debt which the plaintiff has already received through his purchase at the sheriff's sale of a property of the defendant which is now presumed in law to have been worth the full amount of the judgment." 35 A.2d at page 281.

"It was the receipt of a property worth the amount of the judgment which discharged it. The Deficiency Judgments Act

method of determining fair market value. If the mortgagee considers the fair market value to be less than the debt he may have appraisers appointed to have the amount fixed. In effect, the mortgagor is given a legal credit or set-off against the amount of indebtedness owing the mortgagee to the extent of the fair market value of the security which the mortgagee has obtained.[4] Thus this squarely brings the present case within the regulation cited above.

The second string to the government's bow is the administrative decision rendered in 1945 by the Administrator of Veterans' Affairs, 1 Decisions of Administrator of Veterans' Affairs No. 625, pp. 1154–1164 (Jan. 22, 1945). Basically, this administrative opinion is concerned with states where the mortgagee is completely barred from proceeding against the mortgagor even for an actual deficiency in the event of default. It is worthy of note that Pennsylvania does not do so, but merely limits the recovery by the

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merely compelled effect to be given to that fact. We do not know, nor do we think it important, whether the property was actually worth the full amount of the judgment. It may be assumed that it was, for, if it was not, the plaintiff would have moved, before the expiration of the period of limitation prescribed by the Act, to have a lesser value fixed for the property. However that may be, the Act itself has now created a conclusive presumption that the property was worth at least one hundred percent of the judgment." 35 A.2d at page 281.

In accord, *Union Trust Co. of New Castle* v. *Tutino*, 353 Pa. 145, 44 A.2d 556 (1945); *Pennsylvania Co. for Insurance on Lives and Granting Annuities* v. *Scott*, 346 Pa. 13, 29 A.2d 328 (1942).

[4] If the property had been purchased by a third party at the sale, resulting in the receipt by the mortgagee of an amount of cash equal to or in excess of the amount of the debt, the Administrator could hardly claim that the veteran could not raise the defense of payment in full in an action brought against him on his indemnity contract.

mortgagee to the amount of the actual deficiency after giving credit for the fair market value of the property taken over by the mortgagee. We agree with the opinion insofar as it asserts that Congress intended the Veterans Act to be beneficial to veterans throughout the country. Of course, in those states where no deficiency judgments are permitted and thus the mortgagee is completely deprived of its right to collect the full amount of indebtedness, the Act would be ineffectual. In such cases the state law must be presumed to be inapplicable. However, if the Administrator's decision be interpreted as providing that all state laws for the determination of the actual amount of the indebtedness existing at the time of foreclosure are superseded, we must emphatically disagree. We find nothing in the Veterans Act that would lead us to that conclusion and much that convinces us that Congress never intended to deprive veteran-mortgagors of the benefits of Acts such as the Pennsylvania one that is clearly ameliorative. Certainly there was no intention to put these individuals in a worse position than nonveteran-mortgagors.

The VA also replies upon the case of *McKnight* v. *United States*, 259 F. 2d 540 (C.A. 9, 1958). It claims that case holds that all state laws upon the subject of deficiency judgments are superseded by the Veterans Act. There the court held that it need not determine whether the California Deficiency Judgment Act applied because under settled principles of mortgage law, "the value of the mortgagor's equity in the mortgaged property is fixed by the amount bid at the foreclosure sale, and * * * in the absence of fraud, a mortgagor has no right to compel the mortgagee to account to him for any profit made upon a subsequent

resale of the premises." 259 F. 2d at page 544.[7] With this we agree. The case merely stands for the proposition that the amount of the liability of a veteran to the United States is fixed at the time of foreclosure and that subsequent sales of the property can neither decrease nor increase this liability. There is no holding in the case that the amount received by the mortgagee at foreclosure is determined by federal law, and that, of course, is what we must determine in this case.

One other aspect of the Pennsylvania Act deserves our attention. It provides that if no action is taken within the six-month period, not only is the indebtedness to the mortgagee satisfied but the obligor, *guarantor,* or anyone else liable directly or indirectly to the mortgagee is released. This strikingly points up the difference between the Pennsylvania and California Acts, for the latter has been held not to apply to guarantors. *Security-First National Bank of Los Angeles* v. *Chapman,* 41 Cal. 2d 219, 106 P. 2d 431 (1940).

The government's contention that it paid the entire amount of its guaranty prior to the end of the six-month period leads once again to the central question. On what basis did it compute the indebtedness of the mortgagor to the mortgagee so that the amount to be

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[7] Four district court cases, which treat the problem rather summarily, are in accord with the government's position. *United States* v. *Ryder*, 168 F. Supp. 263 (N.D. Ga. 1958); *United States* v. *Jones*, 155 F. Supp. 52 (M.D. Ga. 1957); *United States* v. *Gallardo*, 154 F. Supp. 373 (N.D. Calif. 1957); *United States* v. *Henderson*, 121 F. Supp. 343 (S.D. Iowa, 1953). None of these cases involved a statute such as that in the instant case, and more particularly none considered how the guaranty was to be computed. Rather they assumed that the payment by the government to the mortgagee was authorized under the statute and regulations.

paid under the guaranty, in accordance with the statute and regulations, could have been ascertained? Until the mortgagee indicated, by taking steps under the Pennsylvania Act that it was not satisfied that the fair market value of the property which it then held * was at least equal to the indebtedness, there was no way of calculating any liability of the veteran and in turn any liability of the government on its guaranty. In the absence of such action on the part of the mortgagee within the six-month period, its claim against the veteran was fully satisfied by the security and the guarantor (VA) was released.

The judgment will be affirmed.

In the United States Court of Appeals for the Third Circuit

No. 13067

UNITED STATES OF AMERICA, APPELLANT

v.

GEORGE E. SHIMER

On Appeal From the United States District Court For the Eastern District of Pennsylvania

Present: BIGGS, *Chief Judge,* and STALEY and HASTIE, *Circuit Judges.*

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

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* It must be remembered that the mortgagee is not forced or required to bid in the property, in which event the amount bid by the third party would be credited on the debt.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

APRIL 8, 1960.

[Stamped]
RECEIVED & FILED
APR. 8, 1960
IDA O. CRESKOFF, Clerk

U.S. GOVERNMENT PRINTING OFFICE: 1960